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Ameritech

Celia Nogales
Director - Federal Relations

March 5, 1997

EX PARTE OR LATE FILED

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, DC 20554

RE: **Ex Parte Statement**
CC Docket No. 96-45

Dear Mr. Caton:

On March 4, 1997, Ms. Kristin Shulman, Ms. Barbara Cherry and I met, in separate meetings, with Mr. John Nakahata, Chief, Competition Division, Office of General Counsel; Mr. Doron Fertig, Office of General Counsel; Ms. Kathleen Levitz, Deputy Bureau Chief, Common Carrier Bureau; Mr. Tim Peterson, Counsel to Bureau Chief, Common Carrier Bureau; and Mr. James Coltharp, Legal Advisor to Commissioner Quello, to discuss Ameritech's position in the above referenced proceeding. The attached material was used as part of our discussion.

Sincerely,

Celia Nogales

Attachment
cc: J. Nakahata
D. Fertig
K. Levitz
T. Peterson
J. Coltharp

AMERITECH EX PARTE
PRESENTATION ON UNIVERSAL SERVICE

March 4, 1997

KEY PROBLEMS REMAIN TO HAVE SUSTAINABLE UNIVERSAL SERVICE POLICY

- Regulatory mechanisms to accomplish universal service goals must be *sustainable* with competition in the telecommunications industry.

- Sustainability -- that is, continuing achievement -- of universal service goals over time require *competitive neutrality in effect* among providers. The Federal-State Joint Board also recognized the importance of this competitive neutrality principle.

- There are several ways in which the Joint Board recommendations are not competitively neutral between telecommunications service providers, thereby threatening the ability to achieve the underlying universal service goals over time.

- Ameritech will focus here on the two most critical competitive neutrality problems.
  (1) The need for a competitively neutral pass-through mechanism for telecommunications providers to recover a federal levy to fund an explicit universal service fund.
  (2) The need for a competitively neutral application of carrier of last resort obligations and the definition of an eligible carrier for high cost support funds.

TRUE COMPETITIVE NEUTRALITY ISSUES ARE CLARIFIED BY A UNILATERAL V. BILATERAL RULE PARADIGM

- Government imposes regulation in two fundamental ways.

  (1) *Unilateral rules*: imposition of obligations on firms without any consideration from government to cover the associated costs.

  Examples: taxes, minimum wage laws, OSHA requirements.

  (2) *Bilateral rules*: imposition of obligations coupled with consideration from government to cover at least some of associated costs.

  Examples: food stamps, dual party relay service, traditional utility monopoly franchises, patents.

- Bilateral rules are contracts, where consideration (such as money) is provided in exchange for the obligations imposed on the firm. **The consideration follows the obligation.**

COLLECTION OF FUNDS FOR UNIVERSAL SERVICE IS A UNILATERAL RULE

- The collection of funds from telecommunications service providers for purposes of funding an explicit universal service fund is a unilateral rule .

- To be sustainable, such a unilateral rule must be competitively neutral in effect among providers.

- A unilateral rule, which is neutral on its face, may not be competitively neutral in effect because of its coexistence with other rules.

THE EXISTENCE OF OTHER RULES CAN MAKE THE COLLECTION MECHANISM <u>NOT</u> COMPETITIVELY NEUTRAL

- Ultimately, some combination of customers and shareholders of telecommunications providers will pay for the universal service contributions under this unilateral rule.

- **But, telecommunications providers have <u>different abilities</u> to pass through contributions to customers' rates.**
  - ILEC's
    - Many have rate restrictions or freezes which prevent a pass through to certain customers' rates.
    - Yet, ILEC's have an obligation to serve all local customers.
  - CLEC's
    - Do not have rate restrictions which prevent a pass through to customers' rates.
    - Can choose where and whom to serve, i.e. be niche players, and avoid serving areas where market prices do not permit a pass through to customers.

- As a result, shareholders of ILEC's (not of CLEC's) will likely have to pay a substantial portion of the contributions.

- The effect of other rules -- rate restrictions and obligation to serve -- on the collection mechanism is that <u>CLEC's are provided a competitive advantage in investment markets which will adversely affect ILEC's abilities to invest in facilities.</u>

COMPETITIVE NEUTRALITY REQUIRES AN EXPLICIT PASS THROUGH MECHANISM FOR UNIVERSAL SERVICE CONTRIBUTIONS

- A solution is required to eliminate this non-competitively neutral effect between ILEC's and CLEC's.

  (1) **Provide an Explicit Pass-Through Mechanism**
  The FCC must provide an explicit pass-through mechanism which enables all providers to recover the levy directly from customers (e.g. line item on customers' bills).

  AND

  (2) **Coordinate Pass-Through Mechanism With the States**
  The FCC should work with the States to ensure that state rules or requirements do not prevent implementation of the pass-through mechanism established under (1).

DISTRIBUTION OF UNIVERSAL SERVICE FUNDS ARE BILATERAL RULES

- Each time explicit funding is distributed for a universal service purpose, a bilateral rule is created.
  - Obligation is imposed on a carrier.
  - Compensation is provided to the carrier fulfilling the obligation.

- There are different bilateral rules for different universal service purposes.
  - Lifeline & Linkup Programs <=> Low Income Funding
  - Service to High Cost Areas <=> High Cost Funding
  - Discounts for Educational Institutions <=> Funding for Schools

- If the customer pays only the subsidized price, then the bilateral rule requires that the compensation be paid to the carrier with the underlying obligation that produced the subsidized price.

(1)	customer pays Lifeline & Linkup prices	--->	carrier providing Lifeline/Linkup	<---	low income funding
(2)	customer pays subsidized rates in high cost areas	--->	carrier with high cost area obligations	<---	high cost funding
(3)	school pays discounted prices	--->	carrier providing service to school	<---	schools funding

- **Thus, if the customer pays only the subsidized price, then the funding must go to the carrier with the underlying obligation.**

IMPROPER MATCHING OF OBLIGATIONS AND CONSIDERATION MAKES HIGH COST FUNDING <u>NOT</u> COMPETITIVELY NEUTRAL

- However, the Federal-State Joint Board recommendations propose an improper matching of obligations and consideration with respect to high cost funding.
  - Both ILEC's and CLEC's are eligible for high cost funding, if they satisfy the requirements of an eligible carrier under Sec. 214.
  - But, only ILEC's are to be carriers of last resort in high cost areas.
  - **Greater obligations are imposed on ILEC's in high cost areas, yet ILEC's and CLEC's are to be eligible for the <u>same</u> amount of compensation as eligible carriers.**

- As a result, shareholders of ILEC's (not of CLEC's) will have to bear the higher financial burdens and risks associated with carrier of last resort obligations, but with no compensation for bearing such additional burdens and risks.

- The effect is that the <u>CLEC's are provided a competitive advantage in the ability both to raise investment dollars and to enter markets as niche players</u>. <u>This will adversely affect ILEC's abilities to fulfill carrier of last resort obligations over time.</u>

- Essentially, CLEC's are being paid to creamskim more lucrative market areas and customers. This creamskimming problem is further exacerbated by asymmetrical requirements imposed on ILEC's to unbundle network components and to resell at wholesale rates.

COMPETITIVE NEUTRALITY REQUIRES A PROPER MATCHING OF OBLIGATIONS AND COMPENSATION

- A proper matching of obligations and compensation for high cost funding is required for competitive neutrality and the fulfillment of universal service goals over time in high cost areas.

- Several solutions are possible to achieve such competitive neutrality.

(1) **Eliminate the Obligations**
Eliminate carrier of last resort obligations entirely. But this may not sufficiently address policy concerns for ubiquitous service.

OR

(2) **Asymmetric Obligations & Asymmetric Compensation**
Impose carrier of last resort obligations only on some eligible carriers, but provide such carriers with greater compensation from the universal service fund in order to cover the increased financial burdens and risks of such obligations. In this way, two groups of eligible carriers are created.

OR

(3) **Symmetric Obligations & Symmetric Compensation**
Require <u>all</u> carriers to bear carrier of last resort obligations (i.e. have the same obligations to extend facilities and the same restrictions on exit) in order to be eligible for high cost funding, and compensate eligible carriers on the same basis.

IMPLEMENTATION OF SECTION 254 WITHOUT USING A PROXY COST MODEL

- The preceding competitive neutrality problems exist, whether or not proxy cost models are used for high cost funding purposes.

- The proposed solutions to the preceding competitive neutrality problems also apply, whether or not proxy cost models are used.

- The FCC can proceed with universal service reform, consistent with Section 254 of the Telecommunications Act of 1996, without using proxy models.

    - Proxy cost models only affect high cost funding, therefore, the FCC can implement the other portions of Section 254 (e.g. Lifeline, Linkup, service for educational institutions and libraries, service for rural health care providers) without concern for the proxy model issue.

    - As to funding for high cost areas:
        - Proceed to implement a benchmark against which costs are compared for amount of funding.
        - Limit support for the benefit of residential lines.
        - Implement proper matching of obligations and compensation.
        - <u>For the interim</u>, utilize actual costs (booked costs) to determine costs. Can maintain current study area size, or possibly have larger ILEC's provide costs on a wire center, or some combination of wire centers, basis.
        - <u>For the long term</u>, pursue exploration of other options, such as competitive bidding.